STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

Proposed Rules of Competition Regarding Local Telecommunications Service in Areas Served by Local Telephone Companies with Fewer Than 50,000 Subscribers

REPORT OF THE ADMINISTRATIVE LAW JUDGE

The above-entitled matter came on for hearing before Administrative Law Judge (ALJ) Richard C. Luis on October 27 and October 31, 1997 at the Public Utilities Commission (Commission, PUC) in St. Paul.

This report is part of a rulemaking proceeding held pursuant to Minn. Stat. §§ 14.131 to 14.20 (1997 Supp.) to hear public comment, to determine whether the Public Utilities Commission has fulfilled all relevant substantive and procedural requirements of law applicable to the adoption of the rules, whether the proposed rules are needed and reasonable and whether any modifications to the rules proposed by the Commission after initial publication are substantially different.

The Commission was represented at the hearing by Daniel Lipschultz, Assistant Attorney General, 700 NCL Tower, 445 Minnesota Street, St. Paul, MN 55101. The Agency Staff's Panel included Eric Witte, Esq., Diane Wells and Marc Fournier. Approximately 40 people attended the hearings, 30 signed the hearing register and 7 members of the public made oral presentations. The hearing continued until all interested persons, groups or associations had an opportunity to be heard.

The record remained open for the submission of written comments for 20 calendar days following the hearing, through November 20, 1997. Pursuant to Minn. Stat. § 14.15, subd. 1, five working days were allowed for the filing of responsive comments. At the close of business on December 1, 1997, the rulemaking record closed for all purposes.

NOTICE

This Report must be available for review to all affected individuals upon request for at least five working days before the agency takes any further action on the rules. The agency may then adopt a final rule or modify or withdraw its proposed rules. If the Commission makes changes in the rules other than those recommended in this Report, it must submit the rules with the complete hearing record to the Chief Administrative Law Judge for a review of the changes prior to final adoption. Upon adoption of final rules, the Commission must submit them to the Revisor of Statutes for a review of the form of the rules. The Commission must also give notice to all persons who requested to be informed when the rules are adopted and filed with the Secretary of State.

Based upon all the testimony, exhibits and written comments, the Administrative Law Judge makes the following:

FINDINGS OF FACT

Procedural Requirements

1. On September 2, 1997, the Public Utilities Commission requested the scheduling of a hearing and filed the following documents with the Chief Administrative Law Judge:

   A. A copy of the proposed rules certified by the Revisor of Statutes.

   B. The Notice of Hearing proposed to be issued.

   C. The proposed Statement of Need and Reasonableness (SONAR).

2. On September 15, 1997, a Notice of Hearing and a copy of the proposed rules were published at 22 State Register 426.

3. On September 12, 1997, the Public Utilities Commission mailed the Notice of Hearing to all persons and associations who had registered their names with the Public Utilities Commission for the purpose of receiving such notice.

4. At the hearing, the Public Utilities Commission placed the following additional documents in the record:

   A. The Commission's initial request for comments published in the State Register on May 5, 1997 at 21 State Register 1601, and the comments received in response to that notice.

   B. The Commission's proposed rules, including the approval of the Revisor of Statutes.

   C. The Statement of Need and Reasonableness.

   D. A copy of the transmittal letter showing that the Commission sent a copy of the SONAR to the State Legislative Reference Library.

   E. The Notice of Hearing as mailed and as published in the State Register.

   F. The Certificate of Mailing the Notice of Hearing.

Minn. R. 1400.2200G. requires also that an agency present at the rule hearing a "Certificate of Mailing List". The Commission did not comply with that procedural rule.

The record contains no certification that an agency employee examined the list for accuracy and completeness before mailing the Notice of Hearing. The Commission has established that it mailed the Notice of Hearing to all on the list on September 12, but did not establish at the hearing that it had verified that the list was accurate and complete as of that date. An Affidavit that the list was checked for accuracy and completeness before mailing of the Notice of Hearing was filed with the Administrative Law Judge.

It is found that the Commission's failure to file a Certificate of Mailing List at the time of the hearing did not deprive any person or entity of an opportunity to participate meaningfully in the rulemaking process. It is noted also that all persons named in the list filed on December 22 were mailed notice on September 12, except for three who were placed on the list for the first time subsequent to September 12. Pursuant to Minn. Stat. § 14.15, subd. 5, the Administrative Law Judge disregards the PUC's failure to comply with the procedural requirement of Minn. Rule 1400.2200G. because the agency's failure to comply is a harmless error.

G. A Certificate of Additional Notice given pursuant to the Additional Notice Plan.

H. Comments received by the Commission on the proposed rules after publication of the Notice of Hearing.

5. The documents were available for inspection at the Office of Administrative Hearings from the date of their filing.

Authority to Adopt Rules, Legal Considerations

6. The Commission's general rulemaking authority lies in Minn. Stat. §§ 216A.05 and 237.10. Authority to make rules governing provision of telephone service in areas served by companies with fewer than 50,000 subscribers lies in Minn. Stat. § 237.16, subd. 8(b). It is found that the PUC has general statutory authority to adopt the proposed rules.

7. Under Minn. Stat. § 14.14, subd. 2, and Minn. Rule 1400.2100, one of the determinations which must be made in a rulemaking proceeding is whether the agency has established the need for and reasonableness of the proposed rule by an affirmative presentation of the facts. In support of a rule, an agency may rely on legislative facts, namely general facts concerning questions of law, policy and discretion, or it may simply rely on interpretation of a statute, or stated policy preferences. Manufactured Housing Institute v. Petterson, 347 N.W.2d 238, 244 (Minn. 1984); Mammenga v. Department of Human Services, 442 N.W.2d 786 (Minn. 1989). The Commission prepared a Statement of Need and Reasonableness ("SONAR") in support of the proposed rules. At the hearing, the Commission primarily relied upon the SONAR as its affirmative presentation of the need and reasonableness for the amendments. The SONAR was supplemented by the comments made by the Commission at the public hearing (including written comments on the staff's proposed changes) and in its written post-hearing comments, dated April 8, 1997.

The question of whether a rule has been shown to be reasonable focuses on whether it has been shown to have a rational basis, or whether it is arbitrary. Minnesota case law has equated an unreasonable rule with an arbitrary rule. In re Hanson, 275 N.W.2d 790 (Minn. 1978); Hurley v. Chaffee, 231 Minn. 362, 367, 43 N.W.2d 281, 284 (1950). Arbitrary or unreasonable agency action is action without consideration and in disregard of the facts and circumstances of the case. Greenhill v. Bailey, 519 F.2d 5, 10 (8th Cir. 1975). A rule is generally found to be reasonable if it is related rationally to the end sought to be achieved by the governing statute. Mammenga v. Dept. of Human Services, 442 N.W.2d 786, 789-90 (Minn. 1989); Broen Memorial Home v. Minnesota Dept. of Human Services, 364 N.W.2d 436, 444 (Minn. Ct. App. 1985). The Minnesota Supreme Court has further defined the agency's burden in adopting rules by requiring it to "explain on what evidence it is relying and how the evidence connects rationally with the agency's choice of action to be taken." Manufactured Housing Institute, 347 N.W.2d at 244. An agency is entitled to make choices between possible approaches as long as the choice it makes is rational. Generally, it is not the proper role of the Administrative Law Judge to determine which policy alternative presents the "best" approach since this would invade the policy-making discretion of the agency. A rule cannot be said to be unreasonable simply because a more reasonable alternative exists, or a better job of drafting might have been done. The question is rather whether the choice made by the agency is one a rational person could have made. Federal Security Administrator v. Quaker Oats Company, 318 U.S. 218, 233 (1943).

8. In addition to need and reasonableness, the Administrative Law Judge must assess whether the legislature has granted statutory authority to the agency, whether the agency has complied with proper rule adoption procedures, whether the rule grants impermissible discretion to agency personnel, whether the rule is unconstitutional or illegal, whether the rule constitutes an improper delegation of authority to another entity, or whether the proposed language is impermissibly vague. Minn. Rule 1400.2100.

9. Where the Commission has proposed changes to the rules after publication in the State Register, the Administrative Law Judge must determine if the new language is substantially different from that which was proposed originally. Minn. Stat. § 14.15, subd. 3 (1996). The standards to determine if the new language is substantially different are found in Minn. Stat. § 14.05, subd. 2 (1996).

Analysis of Proposed Rules

10. This Report is limited generally to discussion of the portions of the proposed rules that received significant critical comment or otherwise require examination. Accordingly, this Report will not discuss each proposed rule, nor will it respond to each comment which was submitted. Persons or groups who do not find their particular comments referenced in this Report should know that each and every submission has been read and considered. Moreover, because many of the proposed rules were not opposed, and were adequately supported by the SONAR, a detailed discussion of each section of the proposed rule is unnecessary. The Administrative Law Judge specifically finds that the Commission has demonstrated the need for and reasonableness of provisions of the rules that are not discussed in this Report, that such provisions are within the Commission's statutory authority noted above, and that there are no other problems that prevent their adoption. Where changes were made to the rule after publication in the State Register, the Administrative Law Judge must determine if the new language is substantially different from that which was proposed originally. Minn. Stat. § 14.15, subd. 3 (1996). Unless specifically mentioned herein, any language proposed by the Commission which differs from the rule as published in the State Register and is not discussed in this Report is found not to be substantially different.

11. In its initial comments, filed November 20, 1997, the Commission staff proposed a number of definitions for terms used in proposed rule 7811.0550 911 Emergency Service Capabilities and Requirements. The staff proposed definitions for "circuit", "circuit-routing profile", "default routing", "diversity", "interim number portability", "switch", "tandem", "tandem-based choking" and "telephone exchange area". The definitions proposed on November 20 are all found to be necessary and reasonable, and do not constitute substantial changes because all the terms are used in the text of the Rule Subpart pertaining to 911 Emergency Services.

12. In its response to comments on December 1, 1997, the Commission's staff withdrew the definitions noted in the preceding Finding, pursuant to a vote by the Commission on November 25, 1997 that withdrew the proposal. The Commission feels no anxiety about parties' ability to understand the meaning of terms in parts 7811.0550. The Commission has greater concern about adopting definitions that create unintended consequences. The PUC anticipates less harm from remaining silent than from adopting a definition that is too broad or too narrow.

The staff's Response notes that the Commission has launched a rulemaking to address emergency 911 issues in a more comprehensive fashion (Docket P-999/R-97-609), known generically as the "Phase II Rulemaking", which will cover emergency service, regulatory treatment of Competitive Local Exchange Carriers (CLECs), universal service and service quality. The Commission sees that docket as a better forum for adding further definitions to 911 rules.

It is found that the Commission's decision to postpone further definition of terminology in the 911 emergency portion of these rules is within the agency's discretion.

13. At the hearing, the Administrative Law Judge expressed concern that some of the proposed rule provisions granted the Commission too much discretion. In its December 1 response, the Commission's staff addressed many of those concerns by making clarifying changes to proposed rules identified specifically in the submission. The Commission has now deleted the phrase "but not limited to" from each reference to the term "included" in the rules and has deleted, as unnecessary, the phrase "at a minimum" from sentences introducing applicable criteria throughout the rules. The Administrative Law Judge has examined these changes in each and every instance, and finds them to be necessary and reasonable and not to constitute substantial changes.

14. Proposed Rule 7811.0600, subp. 8 defines "basic local service" to be the services required under part 7811.0600 (a listing of specifics) and "any other services or terms determined by the Commission to be integral to the basic communications, health, privacy or safety needs of customers." In response to an inquiry regarding whether the proposed language grants over-broad discretion to the agency, the staff responded that the latter clause merely recognizes the rapidly evolving telecommunications market, in which services considered now to be exotic or extravagant may become commonplace or essential. Support for the proposal is found in the Federal Telecommunications Act, which defines universal service as an evolving concept to be expanded based, among other things, on whether a service is "essential to education, public health, or public safety. . ." 47 U.S.C. 254 (c). The staff argues that because the Commission can find a service to be "basic" only if the service is integral to basic communications, health, privacy or safety needs of customers, that the language limits the Commission's discretion significantly and provides a workable standard that can be applied case-by-case. They emphasize that the definition of basic local service in the proposal allows the Commission to respond in a timely manner to market changes without the undue regulatory lag involved if the list were to be expanded only through rulemaking procedures. The staff foresees that the PUC may face a disconnection case after the market has evolved to expand the list of essential services beyond those identified specifically at proposed part 7811.0600, but before the list had been updated through rulemaking. In such a case, the Commission can use this definition to apply the more general standard to protect the public interest.

The Administrative Law Judge is persuaded that there are enough safeguards in the proposed rule, when combined with the procedures proposed by the Commission to designate additional services as "basic", to protect against an abuse of discretion. The proposed language is found to be necessary and reasonable.

15. The rules proposed initially required a competitive Local Exchange Carrier (CLEC) to serve the entire service area of an incumbent Local Exchange Company (ILEC or LEC) unless the CLEC provided service entirely through its

own facilities. See generally, proposed parts 7811.0200, 7811.0525 and 7811.0600. The Commission imposed a co-extensive service area requirement on CLECs to protect rural customers from the rate increases that could potentially result from what has come to be known as "cream-skimming" or "cherry-picking."

The Commission voted on November 25, 1997 (as reflected in the December 1 filing by the staff) to reverse its decision regarding the requirement for competing local exchange carriers to serve the entire service area of the incumbent. They voted also to eliminate (as unnecessary) an exception to the co-extensive service area requirement for CLECs using their own facilities exclusively ("local self-provisioned service providers"). The exception was intended, in part, to further the policy of encouraging the development of facilities-based competition, independent of the incumbent's facilities, and based also on an assumption that the substantial cost to a CLEC of providing service entirely through its own facilities limits substantially the risk of widespread cream-skimming.

The Commission has decided now that the public interest would be served better by modifying the rules to eliminate the co-extensive service area requirement. Given that position, the need for an exception (for local self-provisioned providers) to the requirement is obviated.

16. It is found that the decision by the Commission to remove the obligation for co-extensive service on the part of competing local exchange carriers does not constitute a substantial change within the meaning of Minn. Stat. § 14.05, subd. 2. The position arrived at during the vote on November 25 is within the scope of the matter announced in the Notice of Intent to Adopt or Notice of Hearing and in character with the issues raised in that notice. The position taken is a logical outgrowth of the contents of the Notice of Intent to Adopt or Notice of Hearing and the comments submitted in response to the Notice, considering in particular the fact that MCI and AT&T have taken the position espoused by the Commission on November 25 throughout the pendency of this proceeding. The Department of Public Service has also advocated that position. It is noted that the Notice of Intent to Adopt or Notice of Hearing provided fair warning that the outcome of the rulemaking proceeding could be the position finally taken by the Commission.

The persons most affected by the proposed change would be Local Exchange Companies with fewer than 50,000 subscribers. It is noted that their counsel (Richard Johnson of Moss and Barnett) has participated in the rulemaking from the first advisory panel meeting. The subject matter of the proposed rules as modified does not differ from the subject matter of the proposed rules. In general, the modifications merely replace one policy choice with another.

The proposed final modification is subject to questions of statutory authority, necessity and reasonableness, independent of any finding that the rule modifications proposed finally do not constitute a substantial change. Those issues are discussed below.

17. The Commission interprets its rulemaking mandate in this proceeding, particularly Minn. Stat. § 237.16, subd. 8(a)(6), compelling the Commission to "prescribe appropriate regulatory standards for new local telephone service providers that facilitate and support the development of competitive services", to be in conflict with the co-extensive service area requirement proposed initially and published in the State Register. The agency has been persuaded by comments from CLECs that a requirement to offer service throughout the service area of a LEC would be viewed by competitors as a substantial impediment to entry into the market, and the commission has changed its position because of a perceived need not to overlook or dismiss easily this concern. In its December 1 Response, the Commission staff notes "the commission considers the mere risk of cream-skimming insufficient to justify a policy that could seriously thwart the introduction of competition into rural markets. The proposed service area restriction would deny consumers the full range of choices competition is intended to offer".

18. The Minnesota Independent Coalition (MIC) presented a study on the potential cost impact of cream-skimming. The MIC represents incumbent small telephone companies (LECs). MIC acknowledges its study was not based on a statistically valid sample, and the staff's Response notes the study highlights the risk of cream-skimming but does not provide a solid foundation for predicting the extent to which cream-skimming will occur, or the actual impact such cream-skimming would have on rural consumers. While MIC alleged that a large number of unaffiliated CATV (cable television) companies are poised to lure lower cost customers away from rural incumbents if allowed to serve only parts of the service area of those incumbents, it is noted that only a few cable companies have sought permission from the PUC to provide competitive service in the two years since the effective date of the state law allowing competitive entry.

The Commission staff acknowledges some cream-skimming may occur as part of the evolution from monopoly markets to competitive markets in rural areas, but urges that attention be focused on the impact cream-skimming will have on rate payers. It notes that alternatives exist to a LEC's raising its rates to offset lost revenues -- in the alternative, the LEC could choose to reduce its profit margin or operate more efficiently. The staff notes also that existing federal universal service support mechanisms along with access charge revenues may work to offset the price impact of competitive entry sufficiently to keep rates affordable. It is noted the PUC has initiated a docket to establish a state universal service support fund to supplement the federal mechanisms already in place.

19. The staff notes further that the commission can address LEC concerns about rate payer impact of cream-skimming effectively in individual

certification proceedings, where, on a case-by-case basis, the commission will be free to impose a co-extensive service area requirement. In such certification proceedings, the PUC will be able apply Minn. Stat. §§ 237.60, subd. 3 and 237.74, subd. 2, which provide that no local service provider shall limit its service offerings unreasonably to particular geographic areas unless facilities necessary for the service are not available and cannot be made available at reasonable costs. It is found that these statutes do not require all CLECs to match the service area of LECs with which they compete (as MIC suggests). Rather, the statutes authorize the Commission to determine whether any proposed service offerings, including those proposed in the certification petition, include "unreasonable" geographic limits. The Federal Telecommunications Act of 1996, at 47 U.S.C. § 253(f), allows state commissions to require individual CLECs to match the service areas of incumbents in rural areas. State law may, in fact, compel such service area requirements based on the facts presented in a particular case. The Administrative Law Judge is persuaded that certification proceedings provide the appropriate vehicle for addressing cream-skimming and discrimination concerns. It is found that the decision to do so on a case-by-case basis rather than to impose co-extensive service areas on all CLECs by rule is within the PUC's discretion.

20. It is found that the rural provisions providing for co-extensive service territory for CLECs seeking to provide service in the territory of an incumbent LEC, as supported in the Statement of Need and Reasonableness in this matter, is necessary and reasonable. The proposals published initially in the State Register included an exception to the requirement for local self-provisioned service carriers which allowed such CLECs to avoid the excessive costs involved in offering services throughout a LEC's territory. If the commission finds it appropriate to reverse its position again and adopt the rule as published originally, those sections of 7811.0100, 7811.0200, 7811.0300 and 7811.0525 now proposed for deletion are found to be necessary and reasonable.

21. The final modifications proposed at parts 7811.0100, 7811.0200, 7811.0300 and 7811.0525 reflecting the PUC's decision not to require co-extensive service areas for CLECs are found to be necessary and reasonable.

22. At part 7811.0700, subp. 3, the commission requires a LEC to provide a level of service to a CLEC that exceeds the level of service that the LEC provides to itself, if the CLEC asks for the service and agrees to pay "a reasonable portion of the cost".

Incumbent LECs argue that the PUC is without authority to adopt the proposed rule. Specifically, they argue (1) that the commission lacks state authority to adopt such a rule, (2) the Federal Telecommunications Act of 1996, as construed in the recent case of Iowa Utilities Board v. FCC, 120 F. 3d 753 (8th Cir. 1997) preempts state authority to adopt such a rule, and (3) the proposed rule violates the Fifth Amendment of the United States Constitution because it effects a “taking” of utility property without just compensation.

The commission staff is not persuaded by the arguments of MIC and U. S. West on these issues and urges approval of the rule as published in the State Register.

23. The Commission staff notes that the Legislature has given the Public Utilities Commission authority to adopt rules to establish and promote service quality and to promote a competitive telecommunications environment. The staff notes that the proposed rule promotes service quality because it provides a CLEC a means to obtain superior service quality that might otherwise be beyond its reach. In that connection, it maintains the Commission has ample authority to regulate service quality and that among the state goals that should be considered as the Commission executes its regulatory duties with respect to telephone communications services are "maintaining or improving the quality of service." Minn. Laws 1997, Ch. 223, §2, to be codified as Minn. Stat. § 237.011. Section 237.16, subd. 8(a), defining the Commission's rulemaking mandate, requires rules "using any existing federal standards as minimum standards and incorporating any additional standards or requirements necessary to ensure the provision of high quality telephone services throughout the state." It is argued that the statute grants the Commission authority to go beyond the specific mandates of federal law, particularly in the area of service quality.

The staff notes that the proposed rule promotes competition in giving a CLEC the same options the incumbent has for catering to customer demand. The staff notes that Minn. Stat. § 237.011 states that among the goals that should be considered as the Commission executes its regulatory duties with respect to telecommunications services are "encouraging fair and reasonable competition for local exchange telephone service in a competitively neutral regulatory manner" and "promoting customer choice." Also, Minn. Stat. § 237.16, subd. 1(2) provides that the Commission has exclusive authority to establish terms and conditions for the entry of telephone service providers so as to protect consumers from monopolistic practices. The staff argues that this provision enhances the statutory purpose of bringing about fair and reasonable competition for local exchange telephone services.

24. On July 18, 1997, the Eighth Circuit Court of Appeals issued its decision in Iowa Utilities Board v. FCC, 120 F.3d 753 (8th Cir. 1997). The decision struck down Federal Communications Commission (FCC) rules mandating superior service substantially similar to that proposed by the Commission here. MIC, U.S. West, and GTE argue that the rationale used by the Eighth Circuit in its decision binds the Public Utilities Commission here. The Department of Public Service (Department, DPS), AT&T, and MCI argue that the Eighth Circuit found merely that the FCC exceeded its authority and that since the Commission has different statutory authority from the FCC, the Iowa Utilities

Board decision does not limit the P.U.C. from adopting its own rules similar to those of the FCC struck down by the decision. The Commission staff advocates the latter position.

25. At 120 F.3d 753, 812, the Eighth Circuit states that:

> Here, we believe that the FCC violated the plain terms of the Act when it issued these rules.

This pronouncement relates to the FCC's adoption of rules similar to those proposed by the Commission to require a LEC to provide superior service to that which it provides currently to its customers on the request of a CLEC. The MIC, U.S. West, and GTE argue that what the Eighth Circuit meant by "violated the plain terms of the Act" would include what the P.U.C. is proposing in this docket. That argument ignores the fact that the P.U.C. is relying on state-law authority, independent of and not inconsistent with the Federal Telecommunications Act of 1996.

26. It is clear from the Eighth Circuit's opinion that the portion of the Federal Act violated by an FCC rule requiring superior service quality upon the demand of a CLEC is subsection 251(c)(2)(C), which requires incumbent LECs to provide interconnection "that is at least equal in quality to that provided by the local exchange carrier to itself . . . ." The Court decided it was plain that the Federal Act does not require incumbent LECs to provide competitors with superior quality interconnection, or that requesting carriers can receive superior quality access to network elements upon demand. The Eighth Circuit considered the subsection to provide a "floor" below which service quality could not go. 120 F.3d., at 812.

As noted above, the Minnesota statutory authority is different than the authority in the Federal Act providing that interconnection be provided "at least equal in quality to that provided by the local exchange carrier to itself." Minn. Stat. § 237.16, subd. 8(a), authorizes the Public Utilities Commission to adopt rules applicable to all telephone companies and telecommunications carriers "using any existing federal standards as minimum standards and incorporating any additional standards or requirements necessary to ensure the provision of high quality telephone services throughout the state". At a minimum, the statute requires the rules to prescribe standards for quality of service. The question is whether that statute (or rules adopted consistent with it) conflict(s) with the provision of the Federal Act quoted above. The Administrative Law Judge concludes that there is no conflict.

27. Section 252(e)(3), the subject of which is "preservation of authority" to state commissions, provides, in part, that "nothing in this

section shall prohibit a state commission from establishing or enforcing other requirements of state law . . . including requiring compliance with intrastate telecommunications service quality standards or requirements". This subsection is subject to section 253 of the Act.

Section 253 places three limits on state regulations: (1) they cannot prohibit or have the effect of prohibiting the provision of telecommunications service; (2) they must be imposed on a competitively neutral basis; and (3) they must be consistent with the universal service requirements of the Act found at section 254. The issue now becomes whether "competitive neutrality" is assured by the Commission's proposed rule. The staff argues that the rule is designed to give both the incumbent and the competitor equal opportunity to influence service quality, so that the rule is consistent with competitive neutrality principles.

28. In an Order Granting Reconsideration issued on October 17, 1997, the Public Service Commission of Missouri reversed its position regarding requiring a LEC (GTE) to provide to AT&T a higher quality of service than it provides itself. The Commission held that such a position was contrary to the recent opinion of the United States Court of Appeals for the Eighth Circuit, citing Iowa Utilities Board v. Federal Communications Commission, the case noted above. The Commission stated:

> In its prior orders, this Commission was bound to give effect to the rules set in place by the Federal Communications Commission (FCC) to implement the Act. Specifically, 47 C.F.R. §§ 51.305(a)(4) and 51.311(c) require an incumbent LEC (local exchange company) to provide interconnection at levels of quality superior to what the ILEC provides to itself, where technically feasible, upon request of another carrier. The Eighth Circuit found these rules to be inconsistent with the plain language of the Act which requires an incumbent to provide interconnection that is at least equal in quality to the facilities the ILEC provides to itself. (Section 47 U.S.C. 251(c)(2)(C)) The Eighth Circuit vacated 47 C.F.R. §§ 51.305(a)(4) and 51.311(c). The Commission finds that, its Final Arbitration Order shall be modified to the extent that it requires GTE to provide interconnection at levels of quality superior to what GTE provides to itself. Each such directive shall be modified to require GTE to provide interconnection at levels of quality at least equal to what GTE provides to itself.

It is found that the above-noted Missouri decision is instructive, but not controlling in Minnesota. The Administrative Law Judge will base his recommendation to the Commission on his analysis of Minnesota statutes and their interrelationship with the Federal Act.

29. The proposed rule reads:

> The standards in an agreement under subpart 2 may require the LEC to provide the CLEC with services, network elements, or interconnection at a level of quality exceeding that which the LEC provides itself or its affiliates. The CLEC shall pay a reasonable portion of the additional cost of providing the higher quality of service if the higher quality level goes beyond the specific mandates in applicable commission orders or rules. The reasonable portion of additional costs the CLEC must pay must be determined as provided in items A and B:
>
> A. The CLEC shall pay for the higher quality services, network elements, or interconnection based on the proportional benefit the CLEC receives from the higher standards relative to the benefit received by the LEC.
>
> B. The LEC shall demonstrate through its own internal quality measures that the contract standards exceed both the local exchange carrier's internal standards and the standards set forth in applicable commission orders and rules. Disputes regarding payment for higher service levels must be resolved through arbitration under section 252, subsection (b), of the act or through the dispute resolution process set forth in the parties' agreement.

30. The Administrative Law Judge is persuaded that Proposed Rule 7811.0700, subp. 3 (Intercarrier Standards Exceeding Parity) provides the required competitive neutrality. As such, it does not violate the Federal Act.

31. The rule does not require a LEC to provide the CLEC with services, network elements or interconnection at a level of quality exceeding that which the LEC provides itself in the absence of an agreement between the parties. It is presumed the agreement will include a negotiated (or arbitrated) apportionment of costs to reflect the provision of the higher quality of service to the extent the quality level goes beyond the specific mandates in applicable Commission orders or rules. The LECs view this provision as a unconstitutional "taking" of their property.

32. The United States Supreme Court has found that no taking arises until a final government action "jeopardizes the financial integrity of the [regulated] companies, either by leaving them insufficient operating capital or by

impeding their ability to raise future capital." See, Duquesne Light Company v. Barasch, 488 U.S. 299, 312 (1989). This record does not demonstrate that application of the proposed rule would leave LECs with insufficient operating capital or the extent to which it would impede their ability to raise future capital. In addition, the Court noted that "a claim that the application of government regulations effects a taking of a property interest is not ripe until the government entity charged with implementing the regulation has reached a final decision regarding the application of the regulations to the property at issue", citing Williamson County Regional Planning Commission v. Hamilton Bank, 473 U.S. 172, 186 (1985).

In the Iowa Utilities Board decision discussed above, the 8th Circuit noted, regarding the "taking" issue:

> "When a state or the federal government provides an adequate procedure for obtaining compensation, a takings claim is not ripe for review until the litigant has used the procedure and has been denied just compensation."

120 F.3rd 753, 818. The Administrative Law Judge finds that the above-quoted rule subpart provides "an adequate procedure for obtaining compensation" within the meaning of the Iowa Utilities Board decision. It is important to note that the rule does not make the provision of superior service quality mandatory, absent an agreement by the parties on just compensation, except by arbitration on the part of the Commission. The general compensation formula that the CLEC shall pay a reasonable portion of the additional cost of providing the higher quality of service, which would be determined based on the proportional benefit the CLEC receives from the higher standards relative to the benefit received by the LEC, provides competitive neutrality.

33. Some LECs have argued that a lag may occur between the time a LEC incurs an expense to provide superior service and the time the LEC receives full compensation from the CLEC. This concern seems to be a routine "regulatory lag", which is a familiar, and constitutional, aspect of utility regulation. Re Kansas City Power and Light Co., 48 PUR 4th 598, (1982). The Administrative Law Judge agrees with the staff that nothing in the Fifth Amendment requires the Commission to order changes in rates at the time it orders a change in service quality levels. Even assuming the proposed rule constitutes a "taking" , the Fifth Amendment does not require that compensation precede the taking. Hurley v. Kincaid, 285 U.S. 95, 104 (1932). A government agency may take private property for public use, so long as the owner receives compensation through a subsequent proceeding. Ruckelshaus v. Monsanto Co., 467 U.S. 986, (1984).

34. It is found that the Commission has statutory authority to adopt Minn. Rule 7811.0700, subp. 3 as proposed, and that its authority to do so has not been pre-empted by the Federal Telecommunications Act of 1996. It is found

further that adoption of the proposed subpart does not constitute an unconstitutional "taking" of the property of a telephone utility in violation of the Fifth Amendment of the United States Constitution.

35. Assuming that the Commission has the discretion to adopt the rule as proposed, the question remains whether the proposed rules reflects reasonable public policy, or whether adoption of the rule is unnecessary or unreasonable. The staff argues that the rule will help fill the Commission's obligation to promote service quality. Superior service can become available to a CLEC's customers whenever a CLEC demands superior service and is willing to pay for it. To the extent that the incumbent decides to provide the service also, either as a means of competing with the CLEC or because, after incurring the fixed costs to provide the upgrade the LEC decides that the incremental cost of providing the superior service is acceptable, then still more Minnesotans will receive the benefits of superior service.

36. In addition, the staff stresses that the rule is intended to prevent a LEC from using its market power to harm competitors. Only a LEC will have the economies of scale necessary to permit it to make capital investments such as the purchase of a switch, or the widespread installation of fiber-optic cable. Only a LEC has the authority to permit people to perform work on its equipment. In the absence of the rule as proposed, there is no way to assure that a LEC would not block customers of the CLEC or customers of its own from obtaining superior service, so long as the provision of that service requires people to work on the LEC's plant. The staff argues that the proposed subpart is necessary in order to avoid the potential of a monopolistic LEC's withholding a necessary improvement in an unreasonable fashion. The Administrative Law Judge agrees. He believes, also, that the balanced approach contained in proposed subpart 3 regarding the method of compensating a LEC is a reasonable methodology to meet the need. It is found that the agency has demonstrated the need for and reasonableness of Minn. Rule 7811.0700, subp. 3 by a affirmative presentation of facts.

37. Proposed part 7811.0700, subp. 4, makes each local service provider (LSP) "directly responsible to its customers for the quality of service provided to those customers". MCI objects to this provision on the grounds that it "appears to hold CLECs liable for service quality concerns that may be out of their direct control." The rule proposal makes a CLEC responsible to its customers for lapses in service quality, whether or not the lapse was the CLEC's fault. However, the rule does not limit the CLEC's ability to pursue remedies against any responsible parties. The purpose of the proposed rule is to ensure that customers have recourse if quality problems arise and to reduce the risk of customers getting lost in inter-company disputes regarding service quality. Subpart 4 of Minn. Rule 7811.0700 is found to be necessary and reasonable.

38. Proposed part 7811.1700 places the burden of proof with respect to material issues of fact on incumbent LECs in an arbitration proceeding. It allows

the presiding arbitrator to shift the burden of production to the entrant based on which party has control of the relevant information, or to comply with applicable FCC regulations. This subpart contains the same language used in the large company rules (part 7812) and the Commission has applied the same standard in the arbitration proceedings it has conducted to date. The LECs request the Commission to shift the burden of persuasion to the party that asserts a given proposition, and/or to permit the arbitrator to shift the burden of persuasion as appropriate.

The staff argues that most of the critical evidence in arbitrations is within control of the incumbent provider. The incumbent, therefore, is in the best position to come forward with evidence on most of the issues likely to be disputed in an arbitration under the Federal Act.

39. The Commission does not favor reallocating the burden of persuasion from the originally-published subpart 23 provision. It reasons that placing the burden of persuasion on multiple parties eliminates the benefits of having a burden of persuasion, which is a mechanism for drawing a conclusion (as the Commission must do often) in the absence of adequate information.

40. The MIC offers the following amendments to 7811.1700, subp. 23:

That the arbitrator may shift the burden of production <u>and persuasion</u> as appropriate, based upon which party has control of the critical information regarding the issue in dispute and <u>which party is the proponent of the issue in dispute</u>.

The Administrative Law Judge favors this approach. He suggests to the Commission that it adopt that approach on the burden of proof issue, and it is found specifically that such adoption would result in a rule that is necessary, reasonable and not a substantial change (since the issue has been debated thoroughly on the record).

41. It is found that Subpart 23 as proposed initially in the State Register is necessary and reasonable.

42. The Administrative Law Judge urges the PUC to exercise its discretion and provide for an allocation of burden of proof that would be more equitable and applicable in all circumstances, such as that proposed by the MIC. The rule proposed provides that small incumbent LECs have the burden of proof regarding virtually all issues that may arise in the context of an arbitration. While small incumbent LECs will certainly have more information concerning their costs and their capabilities, they will have virtually no information concerning the needs and/or costs of the CLECs relating to particular requests that they may make. It is entirely possible that issues will arise where the CLECs will assert that they are in "need" of a certain service from the small LECs in order to compete. If the small LEC has the burden of proof on that issue, a matter which turns on the

internal operations and/or business plan of the CLEC, it will be virtually impossible for the small LEC to sustain that burden. Such difficulties are particularly acute given the vast differences in sophistication and resources of many small LECs and large experienced CLECs such as AT&T and MCI.

As noted in the initial comments of MIC, the Commission has recognized that it is appropriate for the proponents of a request for a service to bear the burden of proof regarding the need for that service, citing In Re Minnesota Public Utilities Commission, 365 N.W.2d 341 (Minn. App. 1985), which adopted the position taken by the PUC in Docket P-421/GR-82-203. The Court of Appeals upheld the Commission's decision to impose the burden of proof on the proponents of a service, relying on Minn. Rule 1400.7300, subp. 5, which states:

> "The party proposing that certain action be taken must prove the facts at issue by a preponderance of the evidence, unless the substantive law provides a different burden or standard."

The Administrative Law Judge agrees with MIC - such an approach is both sensible and appropriate. To better address the burden of proof issue, it is recommended that the rules be amended to preserve the arbitrator both the customary allocation of the burden of proof and the customary discretion to shift it as appropriate.

43. At Part 7811.2000, subp. 9, the subpart of the rule providing for a rural exemption from negotiation and interconnection requirements dealing with standards for terminating exemption, the Commission staff proposes to add a provision regarding burden of proof. The addition reads, "the burden of production and persuasion with respect to issues of material fact is on the incumbent LEC".

It is found that the additional language proposed for Subpart 9 of Part 7811.2000 is necessary and reasonable and does not constitute a substantial change. It is suggested that the Commission add here the third sentence of proposed Part 7811.1700, giving the arbitrator discretion to shift the burden of production based on who has control of the information. Such an addition is found to be necessary, reasonable and not a substantial change. It is suggested also that the Commission adopt the shifting burden proposed by MIC, for the reasons stated above, at this rule part as well as at Subpart 23 of Part 7811.1700. Such adoption is found to be needed and reasonable and does not constitute a substantial change.

44. The initial comments of US West are instructive in pointing out how the approach espoused at Subpart 23 can work an injustice. In an arbitration involving US West, AT&T, MCI and MFS, an order structured in the same manner as the rule proposed regarding burden of proof adopted hundreds of provisions in a CLEC-proposed contract, over US WEST's objection. The

contract had not been received into evidence during the evidentiary hearings and there was no evidence presented by AT&T or MCI in support of hundreds of complex provisions they sponsored ultimately. Yet, the PUC adopted the contract, with few exceptions, grounding its reasoning in the fact that US WEST had failed to carry its alleged burden of proof to refute the proposed contract terms. US WEST argues that the effect of the application of "burden of proof" in that case, and the likely effect of the rule proposed by the agency here is to exalt form over substance and result in "arbitrated contracts" that never are considered seriously on their merits in many respects. US WEST advocates also the position taken in the amendments proposed by MIC.

45. US WEST argues that proposed Minn. Rule 7811.2200 violates Minn. Stat. §237.035 because it differentiates in the nature and extent of regulation to which a company may be subject under Chapter 237 dependent upon the geographic area the company serves, rather than the upon the number of customers it serves and the nature of the services that it provides. The Commission staff replies that Section 237.035 merely applies all of Chapter 237 to both incumbent LECs and CLECs, except for those sections providing for rate of return regulation, earnings investigations and depreciation accounting. The staff argues that Chapter 237.035 does not require that LECs and CLECs be treated identically.

The staff urges that US WEST's argument ignores the provision of Minn. Stat. §237.16, subd. 13, clarifying the extent to which LECs and CLECs must receive the same regulatory treatment. That statute limits the identical treatment requirement to that period of time before adoption of rules under Subdivision 8 of the same statute. Subdivision 8 (b) of Chapter 237.16 provides for a separate set of rules "as may be appropriate to provision of competitive local telephone service in areas serviced by telephone companies with less than 50,000 subscribers". That is precisely the rule package under consideration here. The Commission staff argues that Subdivision 13 allows it to treat CLECs differently than incumbents after the Commission adopts its rules and that the rulemaking mandate itself recognizes the possibility of distinct regulatory standards for CLECs, providing for Commission rules that "prescribe appropriate regulatory standards for new local telephone service providers, that facilitate and support the development of competitive services". Minn. Stat. § 237.16, subd. 8(A)(6). The Administrative Law Judge agrees. He is persuaded that the CLECs are "new local telephone service providers" contemplated by the statute. Minn. Stat. §237.16, subds. 8 and 13, taken together, chart a regulatory course that allows the Commission to adopt rules treating incumbent LECs and CLECs differently (to the extent that different treatment is necessary and reasonablae).

46. The large company rules (Chapter 7812) state simply that the laws and rules governing incumbent LECs shall also apply to new entrants. The staff argues that that general provision does not work in small LEC areas covered by this rulemaking. While a small number of companies are incumbent LECs under

the large company rules, the proposed small company rules in this docket govern more than 90 incumbents under standards that are defined less clearly than the statutes and rules or alternative forms of regulation governing companies subject to the large company rules. The staff stresses that blanket application of ILEC standards to CLECs in the areas served by the 90 incumbent carriers would be an administrative impossibility and unenforceable. They note that the standards proposed in Part 7811.2200 were developed by the rulemaking task force and are acceptable to both new entrants and incumbents governed by these rules.

47. It is found that the proposed rule 7811.2200, as modified editorially by the Commission in its Response filing, is necessary and reasonable. The changes are clerical in nature and do not constitute substantial changes.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CONCLUSIONS

1. The Public Utilities Commission gave proper notice of the hearing in this matter.

2. The Commission has fulfilled the procedural requirements of Minn. Stat. §§ 14.14, and all other procedural requirements of law or rule. Its failure to file a Certificate of Mailing List at the rule hearing was a harmless error within the meaning of Minn. Stat. § 14.15, Subd. 5. See Finding 4F.

3. The Commission has documented its statutory authority to adopt the proposed rules, and has fulfilled all other substantive requirements of law or rule within the meaning of Minn. Stat. §§ 14.05, subd. 1, 14.15, subd. 3 and 14.50 (i) and (ii).

4. The Commission has demonstrated the need for and reasonableness of the proposed rules by an affirmative presentation of facts in the record within the meaning of Minn. Stat. §§ 14.14, subd. 4 and 14.50 (iii).

5. The additions and amendments to the proposed rules which were suggested by the Commission after publication of the proposed rules in the State Register do not result in rules which are substantially different from the proposed rules as published in the State Register within the meaning of Minn. Stat. §§ 14.05, subd. 2 and 14.15, subd. 3.

6. Any Findings which might properly be termed Conclusions are hereby adopted as such.

7. A finding or conclusion of need and reasonableness in regard to any particular rule subsection does not preclude and should not discourage the Commission from further modification of the rules based upon an examination of the public comments, provided that the rule finally adopted is based upon facts appearing in this rule hearing record.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATION

IT IS HEREBY RECOMMENDED that the proposed rules be adopted consistent with the Findings and Conclusions made above.

Dated this 26th day of December 1997.

RICHARD C. LUIS
Administrative Law Judge

Reported: Angie Threlkeld, Shaddix and Associates
Transcript Prepared